

Appendix A Glossary

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| Bulletin | Once drugs have received approval, from the Minister of Health, for addition or deletion from the Formulary, Manitoba Health is responsible for updating the listing of approved drugs on the Formulary. The listing is updated, via a Manitoba Drug Benefits and Interchangeability Formulary Amendments Bulletin (Bulletin) approximately every three to four months. These Bulletins are posted on the Manitoba Health website and sent to pharmacies and physicians. |
| Drug Program Information Network (DPIN) | Manitoba Health maintains the DPIN computer system - an online, real time computer network system which records and assesses prescriptions at the time they are dispensed. DPIN is linked to all pharmacies in Manitoba. DPIN was established in 1994 as one of the first integrated, real time Pharmacare management systems, and is still one of the most comprehensive in use nationally. |
| Exception Drug Program (EDP) | When a drug is not listed on Part 1 or Part 2, a request for Exception Drug Status (EDS) coverage will be considered under Part 3 for each individual circumstance. |
| Formulary | The Manitoba Drug Benefits and Interchangeability Formulary lists therapeutically effective drugs of proven high quality that have been approved as eligible benefits under the Pharmacare drug benefit program. It also includes a list of interchangeable drugs - drugs that are chemically and therapeutically equivalent. It is compiled with the advice of the Manitoba Drug Standards and Therapeutics Committee, assisted by Manitoba Health staff and outside consultants. The Minister of Health gives the final approval for benefits under the Pharmacare drug benefit program. Updates to the Manitoba Formulary are made available every three to four months by bulletin and via Website. Copies of the Manitoba |

Glossary

Appendix A (cont'd.)

Formulary and the updates are also available at *Statutory Publications*, 200 Vaughan Street, Winnipeg, Manitoba, R3C 1T5. Each new Formulary has three components: a new Bulletin, a revised *Prescription Drugs Cost Assistance Act*, and a revised Manitoba Drug Interchangeability Formulary.

| | |
|--|--|
| Generic Product | A drug product with the same active ingredient, strength and dosage for of a brand name drug product. |
| Manitoba Pharmaceutical Association (MPHA) | <p>Is an autonomous, self-regulating body whose purpose is to protect the public interest in the area of pharmaceutical practice. To maintain that protection, MPhA has been granted powers under <i>The Pharmaceutical Act</i> to:</p> <ul style="list-style-type: none"> • License; • Discipline; • Develop, maintain and monitor standards of practice; • Administer all other requirements of <i>The Pharmaceutical Act</i>. <p>The MPhA officially represents the pharmacists of Manitoba in all areas relating to professional practice.</p> |
| Part 1, 2, 3 Drugs | <p>The Pharmacare drug benefits list (Formulary) is divided into three parts.</p> <ul style="list-style-type: none"> • Part 1 includes drug products that are eligible for Pharmacare benefits under all prescribed circumstances. • Part 2 includes drug products that are eligible for Pharmacare benefits only when prescribed for certain terms and conditions indicated. • When a drug is not listed on Part 1 or Part 2, a request for Exception Drug Status (EDS) coverage will be considered under Part 3 for each individual circumstance. |

Appendix A (cont'd.)

Glossary

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|---|---|
| Personal Health Information Number (PHIN) | Is the unique 9 digit number assigned by Manitoba Health to identify all Manitoba residents for the purposes of administrating the provision of health care services in Manitoba. |
| Pharmacare | Pharmacare is a drug benefit program for any Manitoban, regardless of age, whose income is seriously affected by high prescription drug costs. |
| Professional Fee | Refers to the components that comprise the cost to dispense a prescribed drug by a pharmacist. The dispensing or prescribing fee charged by a pharmacist is to cover the costs of staffing, store operations and overhead, preparing and dispensing prescriptions, assuring appropriate use of medication, and provide a reasonable profit. |
| Provincial Drug Program (PDP) | This is the section of the Manitoba Department of Health and Healthy Living (Manitoba Health) with responsibility for administering the Pharmacare Program within Manitoba. |
| Third Party Insurance | For the purposes of our audit we defined Third Party Insurance to include all prescription drug benefit coverage provided through private for profit drug insurance programs and specific government drug benefit programs provided under the Workers Compensation Board (WCB), Manitoba Public Insurance (MPI) and the Department of Veteran Affairs (DVA). For the purposes of our report, third party insurance did not include benefits covered under other government drug benefit programs with which the Pharmacare program coordinated. |

Pharmacare Deductible Calculator

<http://www.gov.mb.ca/health/pharmacare/estimator.html>

Appendix B

The Pharmacare deductible for the 2007-2008 benefit year is calculated based on the following:

- The total income is determined from line 150 of your 2005 Canada Revenue Agency (CRA) Notice of Assessment.
- Manitoba Health will add the applicant's total income to the total income of the spouse (if applicable).
- \$3,000.00 is subtracted from this total income for one spouse and each dependant under the age of 18 years.
- This equals to what is referred to as the Adjusted Total Family Income.

| Adjusted Total Family Income | Pharmacare Deductible Rate |
|--|----------------------------|
| Less than or equal to \$15,000 | 2.56% |
| Greater than \$15,000 and less than or equal to \$40,000 | 3.83% |
| Greater than \$40,000 and less than or equal to \$75,000 | 4.41% |
| Greater than \$75,000 | 5.51% |

Appendix C

Pharmacare Application Form

<http://www.gov.mb.ca/health/pharmacare/pdf/pharmform.pdf>

Pharmacare Application
and Consent Authorization

Provincial Drug Programs
300 Carlton Street
Winnipeg, Manitoba R3B 3M9



| Please Print - One application per family unit | | Application Deadline - March 31 of Benefit Year | |
|--|-------------|---|--|
| Applicant's Surname | Given Name | Current Marital Status: | Spouse's Surname |
| Manitoba Health Registration Number | | <input type="checkbox"/> Married | Given Name |
| Personal Health Identification Number (PHIN) | | <input type="checkbox"/> Common Law | Manitoba Health Registration Number |
| Social Insurance Number (SIN) | | <input type="checkbox"/> Widowed | Personal Health Identification Number (PHIN) |
| | | <input type="checkbox"/> Divorced | Social Insurance Number (SIN) |
| | | <input type="checkbox"/> Separated | |
| | | <input type="checkbox"/> Single | |
| Current Address | City/Town | | |
| Telephone Number | Postal Code | | |

Note: This information is collected under the authority of section 13 (1) of The Personal Health Information Act and will be used for the purpose of determining Pharmacare benefit eligibility. Eligible prescription purchases are applied to the annual deductible for each benefit year from April 1 to March 31.

Is the Power of Attorney signing on behalf of the applicant and/or spouse?
(If Yes, copies of Power of Attorney documents must be attached)

Yes ☐ No ☐

If applicable, does the Applicant or Spouse reside in a Personal Care Home?

Yes ☐ No ☐

Enrolment Options: **Option A or Option B must be checked.**

| | |
|---|---|
| <p>Option A <u>One Time Program Enrolment</u> <input type="checkbox"/></p> <ul style="list-style-type: none"> ✓ One time application form completion ✓ Deductible is automatically set on April 1 each benefit year ✓ Automated application process ✓ Deductible Confirmation letter will automatically be provided at beginning of each benefit year ✓ Income tax information from two years prior to the beginning of the benefit year is supplied by Canada Revenue Agency | <p>Option B <u>Annual Application</u> <input type="checkbox"/></p> <ul style="list-style-type: none"> ✓ Must apply annually within each benefit year, April 1 to March 31 ✓ Deductible is set only upon processing of application ✓ Must provide satisfactory income information each year e.g. Notice of Assessment from Canada Revenue Agency - Line 150, from two years prior to the beginning of the benefit year |
|---|---|

CONSENT

I hereby consent to the release, to the Manitoba Department of Health by the Canada Revenue Agency, of information from my income tax returns and other required taxpayer information and, if applicable, information from my spouse's income tax returns. This information will be relevant to and used solely for the purpose of determining and verifying eligibility for and for the general administration and enforcement of the Pharmacare program established under The Prescription Drugs Cost Assistance Act and regulations made thereunder, and will not be disclosed to any person without my approval.

This authorization is valid for the two previous taxation years, the current taxation year and for each subsequent consecutive taxation year during which my family unit seeks coverage under the Pharmacare program or someone seeks such coverage on behalf of my family unit. I understand that, if I wish to withdraw this authorization, I may do so at any time by writing to the Pharmacare program.

Signature of Applicant

Date

Signature of Spouse

Date

DECLARATION

I declare that all the information I have provided in this form is complete and where enrolment Option B is chosen, I have fully disclosed my total income from all sources. I also certify that the prescription drug costs for which I am or will be claiming benefits are not covered by another insurer or federal/provincial/municipal program. I understand that a false statement constitutes fraud and may result in recovery of any benefits paid by Manitoba Health.

Signature of Applicant

Date

Signature of Spouse

Date

The completed form can be forwarded to Manitoba Health, 300 Carlton Street, Winnipeg MB R3B 3M9 or faxed to (204) 786-6634. For additional information, please contact our office at (204) 786-7141, toll free 1-800-297-6099 or www.gov.mb.ca/health/pharmacare

Reminder: For this application to be considered complete, Enrolment Option (A) or (B) must be selected and signatures are required in both the Consent & Declaration sections.

Science, Technology, Energy and Mines

**Chapter 4: Compliance with
Oil and Gas Legislation**



Table of Contents

| | | |
|-----|---|-----|
| 1.0 | Main Points..... | 123 |
| 2.0 | Audit Approach | 123 |
| 2.1 | Objectives | 123 |
| 2.2 | Scope and Approach | 124 |
| 2.3 | Subsequent Event | 124 |
| 3.0 | Background..... | 124 |
| 3.1 | Legislation | 124 |
| 3.2 | Program Delivery Structure | 125 |
| 3.3 | Production..... | 125 |
| 4.0 | Promotion of Sound Management of Oil and Gas Resources in Manitoba | 128 |
| 4.1 | Sound Management Practices | 128 |
| 4.2 | Department Monitoring Adherence To Sound Management Practices..... | 130 |
| 5.0 | Permits and Licences..... | 131 |
| 5.1 | Sale of Dispositions | 132 |
| 5.2 | Permitting Process | 135 |
| 5.3 | Licencing Process..... | 139 |
| 5.4 | Lease Agents | 145 |
| 6.0 | Production Taxes and Royalties..... | 146 |
| 6.1 | Production Database | 147 |
| 6.2 | Communication Process to Inform Industry of Changes | 148 |
| 6.3 | Assessments of Production Taxes and Royalties..... | 150 |
| 7.0 | Departmental Response | 154 |

Appendix A: Definition of Terms



1.0 Main Points

The Oil and Gas sector in Manitoba, though small by national or international standards, is a significant component of the provincial economy, especially in the southwestern portion of the province. In 2007, oil and gas production generated just over \$17 million dollars in revenue from royalties, production taxes, and provincially administrated rights and fees. This was more than two and a half times higher than the \$6.7 million from five years prior. The petroleum industry also spent roughly \$324 million in Manitoba for exploration and production in 2007. This was more than three times the expenditures of five years prior.

The purpose of our audit was to evaluate the efforts of the Department of Science, Technology, Energy and Mines (Department) to ensure compliance with *The Oil and Gas Act* and related Regulations in managing Manitoba's oil and gas resources. The Department manages these resources through the administration of several Acts and Regulations.

We found that the Department was appropriately administering the provisions of *The Oil and Gas Act* and related regulations as they related to permits and licenses. We determined that the appropriate amount of taxes and royalties were being assessed and paid on oil and gas production in Manitoba with one exception. In that situation, royalties and taxes were not determined in accordance with the regulation resulting in an under-payment of the royalties and taxes otherwise payable. We also identified the need to improve follow-up procedures where information on royalties and taxes was not being submitted on time; to recalculate taxes and royalties payable on a more timely basis; and to verify submitted information.

2.0 Audit Approach

2.1 Objectives

The objectives for our audit were:

- To determine whether the Department had managed oil and gas resources in Manitoba in compliance with *The Oil and Gas Act* and Regulations (Section 4.0).
- To determine whether permitting and licencing requirements and monitoring powers under *The Oil and Gas Act* were being complied with (Section 5.0).
- To determine whether the appropriate amount of taxes and royalties had been assessed and paid on oil and gas production (Section 6.0).

2.2 Scope and Approach

Our audit focused on the processes in place up to December 31, 2005. Our audit procedures were carried out from March 2006 to September 2007.

As there had not been any gas plant constructor or operator permits issued in Manitoba, we did not perform any audit work related to these types of permits.

2.3 Subsequent Event

Amendments to *The Oil and Gas Act* and *The Oil and Gas Production Tax Act* have been introduced into the Legislature. As of November 2008, these amendments had not been passed. We did not assess the potential impact of these changes on the processes we audited.

3.0 Background

3.1 Legislation

The Department manages Manitoba's oil and gas resources through the administration of various Acts and regulations, which guide the activities of the petroleum industry in Manitoba. They are *The Oil and Gas Act* and the following regulations:

- *The Crown Disposition Regulation* which outlines the procedures and requirements for the sale of exploration rights and the leasing of production rights;
- *The Oil and Gas Lease Agents Regulation* which outlines the requirements for individuals to register as a lease agent in Manitoba;
- *The Geophysical Regulation* which outlines the requirements for exploration for oil and gas deposits, the standards to be used during field operations, and reporting requirements;
- *The Drilling and Production Regulation* which outlines the requirements for well drillers, standards for equipment used in the production process, and the requirements related to reporting, production, and environmental protection; and
- *The Crown Royalty and Incentives Regulation* which outlines the calculations used in determining the payment of royalties on oil and gas production, procedures to be used for payment, and incentive programs offered to oil and gas producers.

The taxes and fees payable by the oil and gas industry on production from privately owned oil and gas rights in Manitoba are governed by *The Oil and Gas Production Tax Act* and the *Oil and Gas Production Tax Regulation*.

3.2 Program Delivery Structure

Responsibility for ensuring compliance with *The Oil and Gas Act* and *The Oil and Gas Production Tax Act* rests with the Petroleum Branch (Branch) of the Department.

The objective of the Branch is to provide for the safe and efficient development of Manitoba's oil and gas resources in accordance with the principles of sustainable development.

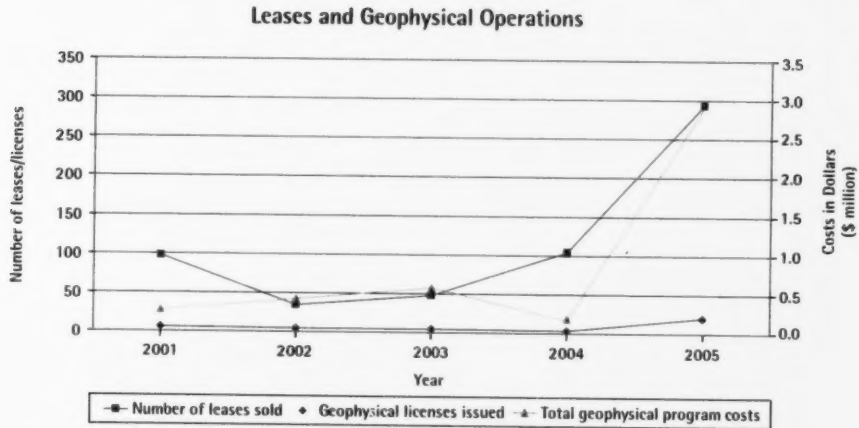
The Branch develops, recommends, implements and administers policies and legislation, to provide for the sustainable development of Manitoba's oil and gas resources. The Branch deals with matters relating to well spacing, production allowables, pool designations, salt water disposal, enhanced recovery projects and unitization. The Branch also collects royalties and taxes due to the Province from the production of oil and gas in Manitoba.

3.3 Production

The chronological process of oil and gas activity begins with an oil production company leasing a parcel of land, which gives the company exclusive right to explore and/or produce from the specific lease or reservation area. Leasing a parcel of land from the government is called "purchasing a disposition". Land can also be leased from private individuals. **Figure 1** shows the increasing number of leases sold between 2001 and 2005.

The oil production company may then perform a geophysical operation on this land, which requires a licence. The results of this operation will indicate where oil deposits under the surface may exist. These results will allow the company to determine where they should place any wells that they are going to drill to increase the chances the well may encounter oil and gas. **Figure 1** displays the increasing number of geophysical licences issued and costs of geophysical operations performed from 2001 to 2005.

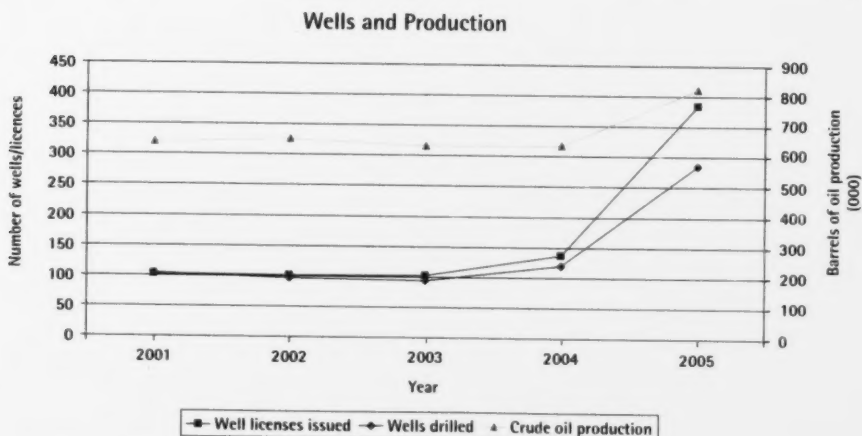
Figure 1



In order to drill a well, the oil production company requires a licence. Figure 2 shows that the number of well licences issued from 2001 to 2005 and the number of wells drilled for the same period increased substantially.

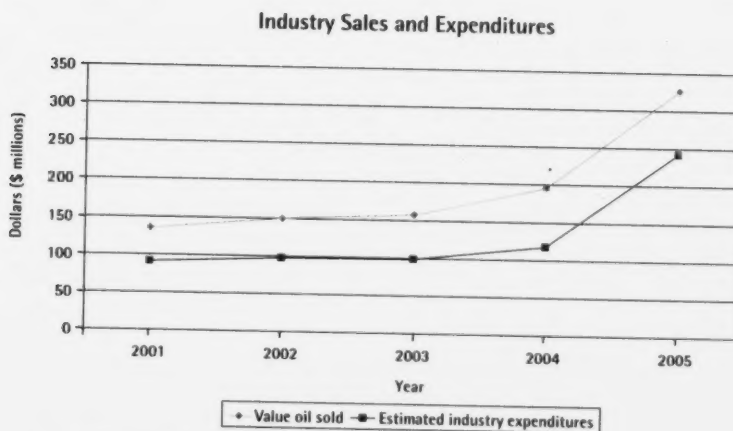
Fluids produced from a well are usually delivered by buried flow lines to a battery. The operation of a flow line requires a licence. The battery is a group of tanks where the initial separation stage takes place to separate the fluid into the components of water, oil and gas. Operation of a battery requires a permit. Figure 2 also shows the increased amount of crude oil produced during 2001 to 2005 as a result of the increased number of wells drilled.

Figure 2



The oil is then delivered from the battery to the location where it is sold to an oil marketing company by either truck or pipeline. Operation of a pipeline requires a licence. **Figure 3** identifies the value of oil sold from 2001 to 2005 and the estimated industry expenditures for the same period. It indicates a sharp increase in 2005, with both sales and expenditures doubling from 2003.

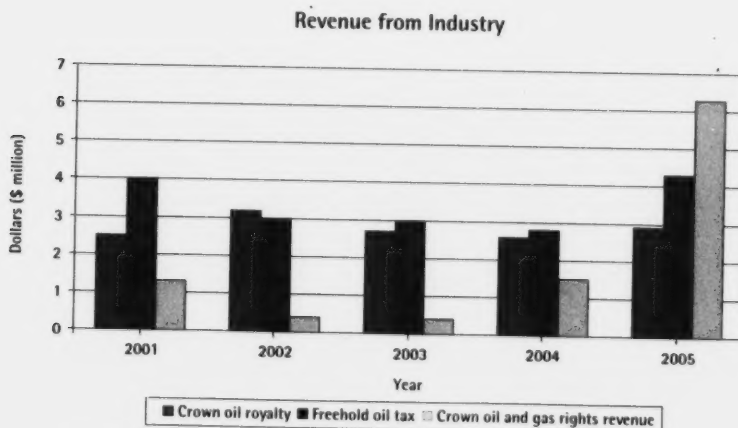
Figure 3



Source: <http://www.gov.mb.ca/iedm/petroleum/stats/index.html>

Legislation requires oil companies to pay either tax or royalties on all oil produced. If the oil is produced from an area under lease with the government, then crown oil royalties are paid. If the oil is produced from an area under lease with a private individual, then freehold oil taxes are paid. **Figure 4** illustrates the increase in royalties and taxes received from 2001 to 2005.

Figure 4



Source: Manitoba Oil Activity Review 2005, Petroleum Branch

4.0 Promotion of Sound Management of Oil and Gas Resources in Manitoba

| Audit Objective and Criteria | Conclusions |
|--|--|
| <p>Our objective was: To determine whether the Department had managed oil and gas resources in Manitoba in compliance with the <i>The Oil and Gas Act</i>.</p> <p>The audit criteria established for this objective were:</p> <p>Section 4.1 The Department should have established sound management practices for the oil and gas industry in Manitoba.</p> <p>Section 4.2 The Department should be monitoring companies in the oil and gas industry to ensure that they are adhering to the government established sound management practices.</p> | <p>The Department had promoted management of oil and gas resources in Manitoba in compliance with <i>The Oil and Gas Act</i>.</p> <p>The Department had established sound management practices for the oil and gas industry in Manitoba by incorporating best practices in its legislation.</p> <p>The Department had a process in place to monitor companies in the oil and gas industry to ensure they were adhering to the government established sound management practices.</p> |

4.1 Sound Management Practices

| Audit Criteria |
|---|
| <p>The Department should have established sound management practices for oil and gas resources in Manitoba.</p> <p>Specifically we looked to determine whether:</p> <ul style="list-style-type: none"> • The Department had outlined what constitutes sound management practices for the oil and gas industry in Manitoba and adequately communicated them to industry (Section 4.1.1); and • The Department had a process in place to ensure that the sound management practices established were consistent with industry best practices (Section 4.1.2). |

4.1.1 Sound Management Practices were Defined in Legislation

Branch personnel informed us that the Department had incorporated standards and industry best practices into legislation. *The Oil and Gas Act* itself was made up of over 20 Parts with over 240 sections. There were also five different regulations that detailed the requirements for the various aspects of the Oil and Gas Industry.

The Branch's primary means of communicating information to industry and other stakeholders was their website, <http://www.gov.mb.ca/iedm/petroleum/index.html>. It provided a direct link to the legislation, informational notices, policy/technical/interpretive publications and other information needed to adequately communicate sound management practices. The Branch also coordinated annual round table meetings with Industry representatives where suggestions and ideas could be presented and upcoming changes identified.

4.1.2 Sound Management Practices were Consistent with Best Practices

Best practices are techniques or methods that are considered by experts in the particular field to be the most effective way to accomplish a task. The Department had incorporated many best practices into their processes and legislation including:

- Requirements for documented certification or licence indicating proficiency in the field of work approved by an expert in that field of work;
- Standards established by various professional associations in the oil and gas industry;
- Recommendations pertaining to environmentally sensitive areas and waterways from the Department of Conservation that were included in permits or licences to be issued;
- Recommendations pertaining to roads and right of ways from the Department of Highways that were included in permits or licences to be issued; and
- Recommendations from industry and professional associations arising from round table forums.

4.2 Department Monitoring Adherence To Sound Management Practices

Audit Criteria

The Department should be monitoring companies to ensure that they are adhering to the government established sound management practices.

Specifically we looked to determine whether:

- The Department had a process in place to ensure the companies were using the sound management practices (Section 4.2.1); and
- The Department had a process in place to communicate deficiencies found, corrective action to be taken and the expected timelines for corrective action (Section 4.2.2).

4.2.1 The Department had a Process in Place to Ensure Sound Management Practices were Followed

The Department employed inspectors and other staff who monitored the companies' compliance with legislation. The Branch had established inspection programs for every aspect of the industry, from the geophysical operation that starts the process right through to the pipeline that transports the product produced. These inspection programs included the requirements outlined in legislation and therefore the sound management practices established. Section 4.0 provides a detailed review of the inspection process for each individual area.

4.2.2 Deficiencies Found were Communicated to any Non-Compliant Company

If an inspector noted areas of non-compliance, a letter was written to the company indicating the issue. A response from the company was requested which was to outline the corrective action that the company would take and in what period.

We reviewed 113 inspection reports throughout the audit. For each file that indicated an issue of non-compliance, the file contained:

- a copy of the non-compliance letter written to the operator; and
- a response from the company that indicated what actions were taken to correct the issue and when those actions occurred.

5.0 Permits and Licences

| Audit Objective and Criteria | Conclusions |
|---|--|
| <p>Our objective was: To determine whether permitting and licencing requirements and monitoring powers under <i>The Oil and Gas Act</i> are being complied with.</p> | <p>The Department was appropriately administering the provisions of <i>The Oil and Gas Act</i> and related regulations as they related to permits and licences.</p> |
| <p>The audit criteria established for this objective were:</p> | |
| <p>Section 5.1 The Department should be selling dispositions in accordance with legislation and consistent with the object and purpose of <i>The Oil and Gas Act</i>.</p> | <p>The Department sold dispositions in accordance with legislation and consistent with the object and purpose of the Act.</p> |
| <p>Section 5.2 The Department should be issuing permits in compliance with <i>The Oil and Gas Act</i>.</p> | <p>The Department issued permits in compliance with the Act using an acceptable permitting process for battery permits. However, the pipeline construction permit process was not documented. In addition, battery and pipeline construction permit application forms were not designed to allow inspectors and engineering staff to sign-off indicating their approval.</p> |
| <p>Section 5.3 The Department should be managing the licence process and issuing licences in compliance with <i>The Oil and Gas Act</i>.</p> | <p>The Department generally had an appropriate licence process and issued licences in compliance with the Act using an acceptable licencing process. However, ongoing geophysical licence inspections were not documented. In addition, well licence application forms were not signed by engineering staff to indicate their approval.</p> |
| <p>Section 5.4 The Department should be registering lease agents in compliance with <i>The Oil and Gas Act</i> and monitoring them to ensure continued compliance with <i>The Oil and Gas Act</i>.</p> | <p>The Department registered and monitored lease agents in accordance with the Act.</p> |

5.1 Sale of Dispositions

Audit Criteria

The Department should be selling dispositions in accordance with legislation and consistent with the object and purpose of *The Oil and Gas Act*.

Specifically we looked to determine whether:

- Public sales of dispositions were in accordance with legislation and an acceptable tendering process as required by legislation (Section 5.1.1);
- Offers to purchase dispositions included appropriate information as required by legislation (Section 5.1.2);
- Exploration reservations and leases were in the approved form as required by legislation (Section 5.1.3);
- Lease areas were within the size parameters allowed by legislation (Section 5.1.4); and
- Dispositions were in accordance with principles of sustainable development as outlined in Section 2(2) of the Act (Section 5.1.5).

5.1.1 Dispositions were In Accordance with Legislation

The process used for dispositions was found in The Branch's *Manitoba Oil and Gas Tenure System Guide* on the website www.gov.mb.ca/iedm/petroleum/tenure/index.html.

The process that the Department used to administer the public sales of dispositions included:

- A producer would apply for the oil and gas rights for a certain parcel of land to be put up for sale. This application included the name of the applicant, the type of disposition requested, the area included in the disposition and any conditions to which the applicant would like the disposition be made public.
- The Branch verified that the Crown held the oil and gas rights for the parcel of land requested through requests to the Land Titles Office.
- The Branch notified the Department of Conservation that the parcel of land was going to be included in the public sale. The Department of Conservation then notified the Branch of any conditions that they felt should be included for that parcel of land.

- The Branch issued a notice entitled "Public Offering of Crown Oil and Gas Rights", which included instructions on how offers were to be made, the parcels of land that were up for sale, and any conditions that would be placed on drilling and production operations in the areas.
- The Branch received sealed offers until the posted closing time for the sale. The offers to purchase were to include the parcel of land being bid on, as well as the amount of the offer including the fees, the first year's rental and any bonus amount. After the sale's posted closing time, Branch personnel opened the offers and selected the highest bid for each parcel.

We observed the only public sale that occurred during our field work (in May 2006). We observed from the point where the sealed bids were opened until the selection of the highest bid for each parcel. There were no deviations from the described process.

We also examined a judgmental sample of 30 current disposition files as displayed in Figure 5. The sample consisted of files from several different years, but focused on dispositions originating in 2004 and 2005.

Figure 5

| Disposition Type | Sample Taken From | | | Total Sample |
|-------------------------|-------------------|------|------|--------------|
| | Prior | 2004 | 2005 | |
| Lease | 10 | 7 | 12 | 29 |
| Exploration reservation | 0 | 0 | 1 | 1 |

- Three of the leases were issued in the mid to late 1950s. This was before the public sale process was started. There were agreements signed for these parcels of land.
- There was documentation of the public sale process for each of the other dispositions.

5.1.2 Offers to Purchase Dispositions Included Appropriate Information

As part of the public sale process, Branch staff reviewed the offers to purchase a disposition to ensure that they included the correct information and were accurate and complete.

We observed the public sale held in May 2006. All offers to purchase a disposition for the public sale included all required information.

All dispositions in our sample (Figure 5) followed the process that was in place and included the information required for the time the disposition occurred.

5.1.3 Exploration Reservations and Leases Were in the Approved Form

All dispositions in our sample (Figure 5) were in the approved form.

5.1.4 Lease Areas were Within the Size Parameters Identified

Legislation required that dispositions be within certain size parameters. Leases were to be less than 768 hectares, while exploration reservations were to be greater than 768 hectares and less than 3,840 hectares.

All dispositions in our sample (Figure 5) were within the size parameters allowed.

5.1.5 Dispositions Were in Accordance with the Principles of Sustainable Development

The branch used the following methods to ensure that they were following the principles of sustainable development in their sale of dispositions:

- Other provincial government departments, including the Department of Conservation, were requested to provide input on the environmental impact that oil and gas activity would have on any potential parcel of land, as well as any other requirements for issuing licences and permits.
- All abandoned sites were required to be rehabilitated to standards that ensured the land was in the same state as before the oil and gas activity took place.
- Standards were set that were consistent with practices across other jurisdictions.
- The department established incentive programs to drill for oil and gas.

5.2 Permitting Process

Audit Criteria

The Department should be issuing permits in compliance with *The Oil and Gas Act*.

Specifically we looked to determine whether:

- The Department had a standard list of requirements for each type of permit (Section 5.2.1);
- The Department had a process in place to update the requirements for the permits (Section 5.2.2);
- The Department had a process in place to ensure permit requirements were met (Section 5.2.3); and
- The Department had a process in place to ensure continual compliance with permit requirements (Section 5.2.4).

5.2.1 There Were Standard Requirements in Place for Each Type of Permit

There were two types of permits issued by the Department:

- Battery permits; and
- Pipeline construction permits.

The Oil and Gas Act, or one of its regulations, identified the requirements for each of these types of permits. The Department requested the Department of Conservation and the Department of Highways to provide any additional requirements that they would impose on the proposed sites. These additional requirements were identified on a case-by-case basis and varied depending on a number of site-specific criteria.

Battery Permit

The Oil and Gas Act identified the requirements for an application for a battery-operating permit. The *Drilling and Production Regulation* outlined further, more specific, requirements related to battery permits regarding:

- Signage;
- Items to include on the application;
- Items to include on an application for modification;
- Maintenance of the battery site;
- Suspension of a battery after six months of inactivity;

- Application to abandon a battery;
- Physical requirements of the battery;
- Compliance with Standard B51-M-1991 of the Canadian Standards Association for all process vessels; and
- Storage, processing and disposal of oil field waste.

Pipeline Construction Permit

Section 149 of *The Oil and Gas Act* specified that a permit was required to construct a pipeline. It also gave the Minister the power to issue a permit on any terms or conditions considered necessary or advisable. Although the terms or conditions were not specified anywhere in legislation, the requirements were that the pipeline be designed, constructed and operated in accordance with CSA standard Z662-03 Oil and Gas Pipeline Systems.

5.2.2 There was a Process to Update the Permit Requirements

The Branch attended annual round table meetings in Calgary. New best practices in the industry were identified at these meetings. The Branch also organized annual round table meetings with the producers in Manitoba. Producers could bring forward ideas for changes to be made at these meetings. Senior Branch personnel would then decide if a recommendation needed to be brought forward to the Minister for a change to a regulation.

We reviewed all ten sets of minutes from the meetings that occurred since 1996. Representatives of various oil and gas companies, as well as representatives of the Branch, attended each of these meetings. At each meeting, the representatives of the Branch gave presentations of new best practices that the government was working on and potential future updates to requirements. The oil and gas company representatives were asked to provide their comments for each of these ideas. The company representatives were also able to ask questions, make suggestions and comment on ideas. This information was used to update requirements where necessary.

5.2.3 There Was a Process to Ensure Initial Permit Requirements Were Met

We examined a sample of each type of permit issued. The sample included all permits issued in 2004 and 2005, as well as a selection from all years prior. These samples are displayed in Figure 6.

Figure 6

| Permit Type | Sample Taken From | | | Total Sample |
|-----------------------|-------------------|------|------|--------------|
| | Prior | 2004 | 2005 | |
| Battery | 12 | 1 | 2 | 15 |
| Pipeline construction | 2 | 0 | 1 | 3 |

Battery Permits

The Department had a documented process that it followed when it received a battery permit application:

- An inspector reviewed the application for completeness and technical submissions. The inspector summarized the application and forwarded this summary to the Branch's engineering staff and Director for approval.
- The Department sent a letter of acknowledgement and a request for missing information to the applicant.
- The Department placed a notification ad in local papers with a minimum 10 day period after publication for objections.
- The Department forwarded any objections or concerns received to the applicant. If the complainant and applicant could not resolve the issues, the Director decided how the issues would be addressed. In most cases issues were addressed by adding conditions to the battery operating permit.
- The Department sent a letter to the applicant indicating approval to construct the battery.
- A qualified inspector, using a Department-developed checklist, inspected the battery when it was ready to go into operation.
- The inspector forwarded the permit to the Director for signature and then forwarded it to the applicant who could then operate the battery.

We reviewed a sample of battery permits (Figure 6) and found that the process was followed in all cases.

Pipeline Construction Permits

The Department had a process that it followed when it received a pipeline construction permit application. This process, however, was not documented in Branch policy or procedure. Department officials advised that the process involved:

- An inspector reviewed the application for completeness and technical submissions.

- The inspector summarized the application and forwarded this summary to the engineering staff and Director for approval.
- The Department requested any missing information from the applicant.

We examined a sample of pipeline construction permits (Figure 6) that showed evidence that each of these steps had occurred.

The lack of a documented policy that outlines the process for pipeline construction applications could result in a permit being issued where not all requirements are met.

We also noted that, for both battery and pipeline construction permits, although there was evidence in the file of the review by the inspector and engineering staff, the application forms did not provide a place for them to indicate they had completed their review and considered the application approvable.

Approval signatures by the inspectors and engineering staff would allow the Director to identify who performed the review if follow up was needed later.

We recommend that the Department document the Pipeline Construction Permit application process and amend the application forms for battery and pipeline construction permits to include a place for inspectors and engineering staff to indicate their approval.

5.2.4 There Was a Process to Ensure Permit Requirements Continued To Be Met

Battery Permits

Permits do not expire; therefore, the Department did not have a renewal process for battery permits. However, the Branch had a performance objective to inspect every battery on an annual basis. The inspectors used the same checklist as for a new battery application. If the inspectors found any items that the permit holder needed to correct, they would issue a notice of non-compliance to the battery operator. The battery operator was required to sign this notice and return it indicating that the permit holder had corrected the items.

We examined the inspection checklists for our sample of 15 batteries. We found:

- for the four year period of 2001 to 2005
 - ten files had annual inspections,
 - one file had three inspections, and
 - four files had two inspections.

- for inspections that indicated an item that needed to be corrected, the Branch had issued a notice of non-compliance to the battery operator and received a response indicating that the item had been corrected.

Pipeline Construction Permit

Permits expire upon completion of the construction of the pipeline. Branch staff informed us that pipelines were inspected numerous times during construction and after construction was completed.

Our examination of the files for three pipeline construction permits revealed that inspections were performed at various times throughout the construction of each of the pipelines and at their completion.

5.3 Licencing Process

Audit Criteria

The Department should be managing the licence process and issuing licences in compliance with *The Oil and Gas Act*.

Specifically we looked to determine whether:

- The Department had a standard list of requirements for each type of licence (Section 5.3.1);
- The Department had a process in place to ensure licence requirements were met (Section 5.3.2); and
- The Department had a process in place to ensure continual compliance with licence requirements (Section 5.3.3).

5.3.1 There Were Standard Requirements for Each Type of Licence

There were four types of licences issued by the Department. These were:

- Geophysical licences;
- Well licences;
- Flow line licences; and
- Pipeline licences.

Geophysical Licence

The Oil and Gas Act required that a licence be held to perform a geophysical operation. The *Geophysical Regulation* outlined further, more specific requirements for a geophysical operation regarding:

- Items to be included in the application;
- One year duration;
- Certain restrictions to geophysical operations;
- Notifications;
- Use of roadways;
- Use of explosives;
- Shot holes;
- Unexploded charges; and
- Submissions and reports to the Branch.

Well Licence

The Oil and Gas Act required that a well operator have a licence. The *Drilling and Production Regulation* outlined further, more specific requirements for a well licence regarding:

- Items to be included in the application;
- Restrictions on well location;
- Notifications;
- Technical specifications;
- Clean up of the well site;
- Necessary application for various operations on an active well;
- Abandoning a well;
- Site clean up and rehabilitation; and
- Certificate of abandonment.

Flow Line Licence

The Oil and Gas Act required that an operator of a flow line must hold a licence. The *Drilling and Production Regulation* outlined further, more specific requirements for a flow line licence regarding:

- Notifications;
- Technical requirements, including compliance with latest published edition of Standard Z662-03 of the Canadian Standards Association;
- Items to be included in the application;
- Pressure testing;
- Suspension of a flow line; and
- Abandonment of a flow line.

Pipeline Operating Licence

The Oil and Gas Act required that an operator of a pipeline hold a licence. It further specified that an application for a licence be made in accordance with the regulations; however, there were no regulations concerning pipeline operating licences. The Branch did require that pipelines be designed, constructed and

operated in accordance with CSA standard Z662-03 Oil and Gas Pipeline Systems. The Department indicated they were preparing to develop a new pipeline regulation under Part 12 of the Act.

There was a process in place to update the requirements, where necessary, as noted in Section 5.2.2. This process was the same for each type of licence.

Departmental staff also considered each licence application for each type of licence on a case-by-case basis to identify any additional requirements that might be necessary. These requirements were dependant on site-specific criteria and included criteria that would minimize physical disturbance, environmental impact, or aesthetic impact on potentially sensitive areas.

5.3.2 There Was a Process to Ensure Initial Licence Requirements Were Met

We examined a sample of each type of licence issued (Figure 7). The sample focused on those licences issued most recently but also included a selection from prior years.

Figure 7

| Licence Type | Sample Taken From | | | Total Sample |
|-----------------------|-------------------|------|------|--------------|
| | Prior | 2004 | 2005 | |
| Geophysical | 0 | 1 | 4 | 5 |
| Well - active | 0 | 0 | 30 | 30 |
| Well - suspended | 3 | 4 | 0 | 7 |
| Well - abandoned | 0 | 12 | 8 | 20 |
| Flow line - active | 8 | 3 | 9 | 20 |
| Flow line - suspended | 0 | 2 | 1 | 3 |
| Flow line - abandoned | 0 | 7 | 0 | 7 |
| Pipeline | 2 | 0 | 1 | 3 |

Geophysical Licence

The Department had a documented process that it followed when it received an application for a geophysical licence:

- The Department sent a letter of acknowledgement to the applicant.
- An inspector checked the site where the geophysical operation was going to take place to determine if they needed to add any conditions to the licence.
- The Department contacted the Department of Highways to allow them to add any conditions to the licence that they might identify from a

"highways" perspective. The Department of Highways was required to sign the licence.

- The Department contacted the Department of Conservation to allow them to add any conditions to the licence that they might identify from a "conservation" perspective. The Department of Conservation was required to sign the licence.
- The Director signed the licence and forwarded it to the applicant.

Our examination of a sample of geophysical licence files (**Figure 7**) found that the procedures were followed in every case.

Well Licence

The Department had a documented process that it followed when it received an application for a well licence:

- Department staff reviewed the application to ensure all required information was included.
- An inspector reviewed the application and may inspect the proposed well site for safety, environment or potential non-compliance issues.
- Departmental engineering staff reviewed the application.
- The Director reviewed the application and approved it.
- The Department required the company to submit specific pieces of information during drilling. An inspector reviewed it when it was received.
- An inspector conducted a "6 week well check" to address any non-compliance issues.

Our examination of a sample of active well files (**Figure 7**) found that the procedures were followed in every case.

We also noted that although there was evidence in the file of the review by the engineering staff, the application form did not provide a place for them to indicate they had completed their review and considered the application approvable.

Approval signatures by the engineering staff would allow the Director to identify who performed the review if follow up was needed later.

We recommend that the Department amend the application form for well licences to include a place for engineering staff to indicate their approval.

Flow Line Licence

The Department had a documented process that it followed when it received an application for a flow line licence. This process involved:

- Department staff reviewed the application to ensure that all required information was included.
- An inspector reviewed the application to determine if any modifications were needed.
- The Department issued written approval to construct to the company.
- An inspector performed a pressure test of the flow line after it was constructed and before it was put into full operation. It was required to maintain a constant pressure for four hours to be considered successful. An inspector witnessed the pressure test and gave approval to activate the flow line.

Our examination of a sample of active flow line licence files (Figure 7) found that the procedures were followed in every case.

We also observed one pressure test of a flow line that was successful.

Pipeline Licence

The Department had a process that it followed when it received an application for a pipeline operating licence. This process involved:

- Department staff reviewed the application to ensure that all required information was included.
- An inspector reviewed the application to determine if any modifications were needed.
- Departmental engineering staff reviewed the application to ensure that the plan met the CSA Standard Z662-03 Oil and Gas Pipeline Systems.

Our examination of a sample of pipeline licence files (Figure 7) found that the procedures were followed in every case.

Suspend or Abandon a Well or Flow Line

A company that wanted to suspend or abandon a well or flow line was required to complete and submit an "Application to ..." form. An inspector and departmental engineering staff were to review these applications. They would add conditions to the approval of the application to address any concerns that they might have. The Director signed the approved application.

Our examination of a sample of suspended or abandoned wells and flow lines (Figure 7) found that the procedures were followed in every case.

We also noted that, although there was evidence in the file of the review by the inspectors and engineering staff, the application form did not provide a place for them to indicate they had completed their review and considered the application approvable.

Approval signatures by the inspectors and engineering staff would allow the Director to identify who performed the review if follow up was needed later.

We recommend that the Department amend the "Application to ..." form to include areas for inspectors and engineering staff to indicate their approvals of the application.

5.3.3 There was a Process to Ensure Licence Requirements Continued To Be Met

Geophysical Licence

The Department issued a geophysical licence for a geophysical operation over a specific geographical area. The Department required the licence holder to submit specific pieces of information at various points throughout the operation, including the completion date. An inspector reviewed the submitted information for potential non-compliance issues and performed spot checks of the geophysical operation at each of the various stages of the operation. However, as these inspections were not documented, we were not able to audit this part of the process.

We recommend that all ongoing geophysical licence inspections done by the Branch be documented.

Well Licence

Historically, an inspector would inspect every well annually. In 2004, due to increased industry activity, the Department developed a new policy on how often to inspect wells. They decided to inspect wells licenced to smaller operators or operators with a history of non-compliance issues annually and wells licenced to larger operators once every four years.

Inspectors used a standard checklist when inspecting an active well, which included:

- Lease entrance condition;
- Specific safety features;
- Leaks; and
- Site maintenance.

Flow Line Licence

After a flow line operator completed construction of a flow line, and prior to putting it into operation, an inspector was required to witness a pressure test of it. Subsequent to putting the flow line into operation, the operator was required to report any repairs to the line. When the repairs were finished, the line was once again pressure tested, which an inspector witnessed. Additional monitoring of the flow line was performed through the regular inspections of the well or battery at each end of the line.

5.4 Lease Agents

Audit Criteria

The Department should be registering lease agents and monitoring them to ensure continued compliance with *The Oil and Gas Act*.

Specifically we looked to determine whether:

- The Department had a standard list of requirements for lease agents (Section 5.4.1);
- The Department had a process in place to ensure lease agents met the requirements (Section 5.4.2); and
- The Department had a process in place to ensure that lease agents continued to comply with their requirements (Section 5.4.3).

5.4.1 There were Standard Requirements for Lease Agents

The Oil and Gas Act, as well as the *Oil and Gas Lease Agents Regulation*, included the requirements for lease agents.

The Oil and Gas Act outlined the requirement for an oil and gas lease agent to be involved in any purchase of an oil and gas interest. It also required that all oil and gas lease agents be registered. The *Oil and Gas Lease Agents Regulation* further specified what was required for an oil and gas lease agent to be registered including:

- Items to be included on the application;
- Registration term; and
- Renewal requirements and fees.

There was a process in place to update these requirements, where necessary, as noted in Section 5.2.2.

5.4.2 There Was a Process to Ensure Initial Oil and Gas Lease Agent Requirements Were Met

Department staff reviewed the application prior to the lease agent being registered to ensure the application included all necessary information.

Our examination of a sample of current oil and gas lease agents found that the applications for registration were complete and in the appropriate form.

5.4.3 There Was a Process to Ensure Oil and Gas Lease Agent Requirements Continued To Be Met

The *Oil and Gas Lease Agents Regulation* stated that the registration of an oil and gas lease agent was only valid for a term of two calendar years. It further stated that renewal of the registration would take essentially the same form as the initial registration.

Department staff advised us that two months prior to expiration the Branch notified the lease agents that their registration was about to expire. The lease agent would then apply for a new registration.

6.0 Production Taxes and Royalties

| Audit Objective and Criteria | Conclusions |
|--|---|
| <p>Our objective was:</p> <p>To determine whether the appropriate amount of taxes and royalties have been assessed and paid on oil and gas production in Manitoba.</p> <p>The audit criteria established for this objective were:</p> <p>Section 6.1</p> <p>The Department should have a database kept up-to-date of all areas on which production tax or royalty should be paid.</p> <p>Section 6.2</p> <p>The Department should have a communication process in which oil and gas companies are kept informed of requirements and changes.</p> | <p>The appropriate amount of taxes and royalties were being assessed and paid on oil and gas production in Manitoba with one exception.</p> <p>The Department had a complete list of wells in Manitoba and kept this list up-to-date.</p> <p>The Department had a process to keep companies informed of changes to requirements and received information submissions in a timely manner with few exceptions. However, they did not have a process to follow-up on information that was not submitted by the deadline.</p> |

| Audit Objective and Criteria | Conclusions |
|--|---|
| <p>Section 6.3</p> <p>The Department should have a process in place to ensure that production taxes and royalties are assessed correctly.</p> | <p>The Department had a process to recalculate taxes and royalties payable, however, this process was three years behind and information submitted was not verified by the Department. There was one instance where royalties and taxes were not determined in accordance with the regulation, resulting in under-payment of the taxes otherwise payable.</p> |

6.1 Production Database

| Audit Criteria |
|---|
| <p>The Department should have a database kept up to date of all areas on which production tax or royalty should be paid.</p> <p>Specifically we looked to determine whether:</p> <ul style="list-style-type: none"> • The Department had a complete list of all wells in Manitoba (Section 6.1.1); and • The Department had ensured that their information was kept up to date (Section 6.1.2). |

6.1.1 The Department Had a Complete List of Producing Wells in Manitoba

The Manitoba Oil and Gas Well Information System (MOGWIS) included all wells licenced in Manitoba. The system tracked production for the well until the well was officially abandoned.

We examined a sample of 77 wells and found that they were all included on MOGWIS.

6.1.2 The Department Had Kept the MOGWIS Up-To-Date

The Branch inputted the production and price information into the MOGWIS system as it was submitted by the companies.

We examined a sample of 77 wells and found that the information for each was up-to-date.

6.2 Communication Process to Inform Industry of Changes

Audit Criteria

The Department should have a communication process in which oil and gas companies are kept informed of requirements and changes.

Specifically we looked to determine whether:

- The Department kept companies informed of changes to requirements (Section 6.2.1); and
- The Department ensured that companies submitted their information in a timely manner and followed up on late submissions (Section 6.2.2).

6.2.1 The Department Had a Process to Keep Companies Informed of Changes to Requirements

Legislation specifies the production tax and royalty requirements. The Branch website listed the requirements regarding reporting of oil and gas production and tax submissions. Department officials advised us that they notified all companies concerned by mail of any change to legislation or policy, and posted the change on the website.

As a rule, the Department and the oil companies worked together to develop the most appropriate legislative framework in relation to the industry. There were annual round table meetings with producers at which policy and regulation items were discussed. When there was a change to regulations, or policy, the producers should have been aware of the change well before the Department had actually implemented it.

6.2.2 The Department Received Information Submissions in a Timely Manner With Few Exceptions But Did Not Follow-up on Late Submissions

Section 8 of the *Crown Royalty and Incentives Regulation* specified, "The holder shall forward the money payable on the Crown royalty to the registrar...not later than the last day of the month following the producing month".

Section 8(2) of *The Oil and Gas Production Tax Act* specified, "An operator or special operator that fails to file a return or a complete return with the tax payment within the time allowed for the tax payment is liable to a penalty".

These excerpts indicate that there was a period in which production companies were supposed to submit their production taxes; however, neither *The Oil and Gas Production Tax Act* nor its regulation specified an allowed period.

In practice, the production companies submitted their production taxes at the same time as the royalties. The Department has indicated that they will amend the regulation to include a monthly submission date for taxes identical to the submission date for royalty payments.

We found that the information was usually received on a timely basis; however, the Branch had no documented process to ensure that companies submitted the information within the required time.

Of the sample of 35 royalty submissions reviewed, the production companies submitted their information to the Department within one week of the end of the month following the producing month with the following exceptions:

- Of the 35 royalties reviewed:
 - There were 11 instances where the production companies submitted their information (production reports and royalty payments) after the last day of the month following the producing month.
 - 10 were submitted within one week of the last day of the month following the producing month; and
 - One production company submitted their information 17 days late.

There were five instances where the well was not producing anything in the applicable month, and therefore the production company submitted no information regarding that well. Production companies only submitted information for producing wells.

Section 193 of *The Oil and Gas Act* allowed for interest to be applied to royalties payable and production taxes payable that were not submitted within the allowed time period.

Section 8 of *The Oil and Gas Production Tax Act* allowed for additional penalties to be applied to late submissions of Production taxes payable.

The Branch did not have a process in place to follow up on late submissions of royalties or production taxes.

At an interest rate of prime plus 4% as prescribed by the provincial government for other tax debts, the Department could have charged minor dollar amounts on late royalty submissions and late tax submissions. As the penalties for late submissions of taxes and royalties would have been small, it is reasonable that the

Department did not take the administrative steps to follow-up on these particular late submissions.

6.3 Assessments of Production Taxes and Royalties

Audit Criteria

The Department should have a process in place to ensure that production taxes and royalties are assessed correctly.

Specifically we looked to determine whether:

- The Department recalculated taxes and royalties payable (Section 6.3.1); and
- The Department verified data submitted (Section 6.3.2).

6.3.1 The Department Had a Process to Recalculate Taxes and Royalties Payable, However This Process Was Three Years Behind

Monthly submissions by the oil companies included the production amount for each well and the price received for the oil. This information was entered into MOGWIS upon receipt and then used to perform a recalculation of the Production Tax or Royalty payable. The process had an individual staff member recalculate the production taxes or royalty payable on each spacing unit within two months of the submission of the payment. The recalculation was done using a template.

We reviewed the formulas in the template and compared them to the calculations as described in the regulations. We found they were being performed correctly and in a manner consistent with the regulations.

As of October 2006, they had substantially completed the manual recalculations up to the end of 2003. The current situation was as follows:

- Submissions from all large companies had been recalculated to the end of 2003.
- Submissions from smaller companies had been completely recalculated for 2002, and some had been performed for 2003.
- From January 2004 to present there had been some recalculations performed, and management kept an eye on the amounts being submitted. Any large variances were to be investigated.

We reviewed a sample of 19 production tax submissions and 15 royalty submissions from 2003 and verified that the Branch had performed the

recalculation process as described. We also verified that they had followed up on all discrepancies.

The Petroleum Branch communicated discrepancies noted during the recalculation to the production company. Branch staff informed us that the companies involved were aware that the Branch was three years behind in their recalculations and would eventually review all submissions once the new system was in place.

Because the Branch was so far behind on their recalculations, follow-ups on any issues were not occurring on a timely basis. They were currently doing recalculations for 2003; therefore, the Branch had not identified nor communicated any issues in the intervening time to the oil companies. The Branch planned to have all recalculations done by March 31, 2009.

We reviewed a sample of 42 production tax submissions and verified the accuracy of the submission. We also reviewed a judgmental sample of 35 royalty submissions and verified the accuracy of the submission for them. All discrepancies that we found from the recalculation of these submissions had also been found through the Branch's recalculation process.

Due to the increase in the number of wells in Manitoba, and the related increase in the amount of production, as well as the change over to a new system (see Section 6.3.1.1 below), the Branch had not been able to keep up with their recalculation process.

This resulted in errors not being found in calculations up to a year after the production. However, with the implementation of the new system these recalculations should be able to be done on an up to date basis.

We recommend that the Branch complete the implementation of their new tax and royalty system in order to perform tax and royalty recalculations automatically and on a more timely basis.

6.3.1.1 The Department was implementing a new recalculation system

The Branch had developed, and began to implement, a new system that would include all wells in production in a database. It would be updated with current production amounts and average prices each month, and based on the inputted values, it would automatically recalculate the royalties or taxes owing.

To assist in the auditing function of the new system, the Branch introduced new requirements to have companies submit all production information digitally. Electronic data submission would eliminate the re-keying of data and accompanying errors. Department officials advised us that almost all companies had now completed the testing and verification of data required for their digital data submissions.

Upon completion and final verification of the digital submission process, the audit comparison function will continue with an expected completion by the end of March 2009. The process has taken significantly longer than anticipated as every company had different issues to resolve before being able to submit data electronically.

We recommend that, prior to final implementation of the new system, the branch perform a review of the new system to ensure it is operating effectively and doing the recalculations correctly in accordance with the regulations.

6.3.1.2 One situation of an error in calculation of royalties

Section 7(2) of the *Crown Royalty and Incentives Regulation* stated:

"the fair market value of oil and gas at the wellhead is an amount equal to the total of any posted price of the oil and gas during the producing month less all reasonable and necessary transportation expenses, as approved by the registrar, incurred for the purpose of transporting the oil and gas from the wellhead to the place at which the posted price is determined".

As stated above, the actual expenses incurred to transport the oil, or a fair estimate of such, are allowed to be deducted in calculating royalties and production taxes.

In our review of pipeline licences, we found one pipeline licence application from a company that also produced oil. Rather than attempt to calculate the cost of the pipeline as it applied to the production of oil, the company requested permission to instead deduct the fair market value of transportation costs as transportation expenses in determining their royalty and production taxes payable on production. The Branch provided a temporary approval pending review from July 19, 2006.

By using the fair market value of transportation costs instead of the actual pipeline transportation expenses incurred, the company may have paid over \$6,000 less than they should have in production taxes and royalties for April 2007, based on the actual production for the month and an assumption of some costs. Similar production on an annual basis would result in an annual production tax and royalty under-payment of \$72,000.

We recommend that the Department ensure that oil producing companies calculate, and pay, their royalties and production taxes in accordance with the regulation.

6.3.2 The Department Did Not Verify Submitted Information

The Branch performed limited procedures to verify production and price information submitted by companies. They verified the total volume that was delivered from a battery to the pipeline where it was sold; however, they did not verify the production of individual wells.

They reviewed the price the company submitted as what they received for their oil and compared it to a market price for the same period. If the price was within a certain percentage they accepted it as reasonable. They did not, however, review the records of the company to verify the price they received for their production.

The Branch did not use the powers available to it through legislation to audit the books and records of production companies.

Production companies were responsible for different amounts of taxes and royalties to the government or individual oil and gas rights holders depending on when the well began producing, how much the well had produced in its lifetime, and from whom the company had leased the oil and gas rights.

There was the potential for production companies to misrepresent their production or the price they received for their production.

For example, a company with multiple wells could have increased the production reported by one well, and decreased the production reported by another well in order to pay lower taxes or royalties.

A company could have reported that they received a lower amount for their oil than they actually did, and as long as the price reported was still within a certain percentage of the price used by the Branch, the Branch would not question it.

There are a number of factors within the system that significantly reduce the risk of companies misrepresenting production or price. They include unit operations, requirements for quarterly individual well production tests, battery pro-rationing factors, truck tickets for tracking fluid movement, joint venture ownership scrutiny, and remedies for mineral owners under their oil and gas lease.

We recommend that the Petroleum Branch audit the production records of individual wells and the price production companies receive for their oil on a rotating sample basis to ensure correct production and prices are reported and thereby ensure the correct amount of royalties or taxes are paid.

7.0 Departmental Response

In addition to the OAG's recommendations, the department has committed to developing pipeline regulations under The Oil and Gas Act and amending the Oil and Gas Production Tax Regulation to include a monthly reporting date for production tax. These two commitments are included in the report. Based on comments in the report, the Branch has also adopted a method of tracking the receipt of payments of royalty/tax that are not submitted on time.

The following contains the department's response to the recommendations contained in the report.

Permitting Process (Section 5.2.3)

The Department will prepare written guidelines for review of Pipeline construction Permit applications. All permit application reviews and recommendations will be signed off by engineering and inspection staff who performed the review to provide for follow-up on any matters arising under the permit.

Licensing Process (Section 5.3.2)

The Department has amended the well licence application form to provide a place for engineering and inspection staff who reviewed the application to sign off.

Licensing Process (Section 5.3.2)

The Department has amended the "Application to..." form to provide a place for engineering and inspection staff who reviewed the application to sign off.

Licensing Process (Section 5.3.3)

The Department will develop guidelines for inspection of geophysical operations including requirements that all inspections be documented and placed on the geophysical licence file.

Tax and Royalty Assessments (Section 6.3.1)

The department is completing the verification of the oil production, oil price and other data that must be entered into the new Royalty and Tax Audit System database before the system can be used to audit company royalty and tax submissions. The data verification should be completed by March 31, 2009.

Tax and Royalty Assessment System (Section 6.3.1.1)

The royalty and tax formulae in the new Royalty and Tax Audit System have been rigorously tested against all the different royalty/tax scenarios provided for under the Crown Royalty and Incentive Regulation and The Oil and Gas Production Tax Act. Any over/under royalty/tax payments will be brought to the attention of oil producers. Producers' review of any over/under royalty/tax payments will provide additional verification of the operating effectiveness of the new system.

Royalty Calculation (Section 6.3.1.2)

The Department proposes to amend the Crown Royalty and Incentive Regulation to outline how and under what circumstances the fair market value of oil and gas at the wellhead will be determined.

Verification of Production and Price Information (Section 6.3.2)

The Department will develop guidelines for auditing of company production records to ensure the accuracy of individual well production data and for auditing of oil price companies receive for their oil production. Individual company production and price audits will then be prioritized and scheduled on a rotating basis in accordance with the guidelines. It is likely that oil production and price audits will be carried out in tandem.

Preparations for a production audit of one company to determine whether the company is in compliance are currently underway.

